

America. Alestra, AT&T's Mexican joint venture with Grupo Alfa and VISA-Bancomer, is the number one new entrant in the Mexican long distance market, with over one million lines presubscribed.

The total EBIT and EBITDA dilution from AT&T Solutions, online services, and international markets were \$162 million and \$124 million, respectively, in the fourth quarter, and \$1,097 million and \$917 million for the year.

Stakes In the Ground - Year-end Report

In March 1997, AT&T's management team put forth a set of targets by which the company's performance could be measured throughout 1997. The chart below represents the "report card" for those targets.

<i>BUSINESS MARKETS STAKES</i>	<i>YEAR-END REPORT</i>
Grow Core Revenue 4% - 6% (Note: revenue comparisons exclude impacts of businesses sold in 1997)	Grew 3.5% for the year and 4.0% in 4Q; the competitive pricing environment and the flow-through of access savings to customers accounted for the shortfall
Grow Data Revenue At Double-Digit Rate	Target achieved-growth in mid-teens
Expand Market Position In Frame Relay & MNS	Target achieved-both grew above industry rate
Cover 70% Of LD Base With Local Service Capability	Target achieved, with AT&T Digital Link in 49 states
Maintain Market Leadership In Web Hosting	Currently among leaders with nearly 7,000 sites hosted
Reduce Gaps In Cost Benchmarks	Streamlined marketing and customer care organizations; achieved SG&A reductions
<i>CONSUMER MARKETS STAKES</i>	<i>YEAR-END REPORT</i>
Grow Minutes At Industry Rate By 4Q	Grew in low single digits in 4Q-below industry rate-partly due to targeting strategy
Stabilize Revenue By Year End	Revenue down slightly for full year adjusted for free minutes and access flow-through; 6.8% revenue decline in 4Q due to access flow-through and migration of customers to optional calling plans, free minutes and

	targeting efforts
Improve Unit Cost Run Rate 8% By Year-End	Target achieved
Less Than 20% Of Acquisitions By Check In 4Q	Target achieved
Increase By 5% Customers With 1+ Years Of Tenure	Stake no longer relevant after strategic shift to targeting of high-value customers
Local Available In Markets With 55% of LD revenue	Local entry plans altered due to economic and regulatory conditions; currently evaluating alternative methods of providing local service to consumers
5 New Distribution Agreements By 2Q	Target achieved
4 New Services In Network By 3Q	Target achieved
4 New Value Bundles By 4Q	Target achieved
WIRELESS SERVICES STAKES	YEAR-END REPORT
Roll Out 10-14 New Markets In 1997	Built out 10 markets; launched 9, with additional launch pending a partnership agreement. Also launched Boston market on January 15.
Grow Revenue At Industry Rate	Total revenue grew 12.9% and cellular markets (850 MHz) services revenue grew 12.1% in 1997 (both adjusted for exchange of Arkansas properties in 1996)
Continue Leadership In Digital Service	1.7 million consolidated digital customers (2.1 million total) at December 31, 1997-leading digital provider in the U.S.
Reduce Marketing Costs 5% - 10%	Achieved 6.1% decrease in cost per gross add in 1997
Deploy Wireless System In Taiwan	Far EastTone GSM system built-out; launched in January 1998
LOCAL SERVICES STAKES	YEAR-END REPORT
Complete And Implement Interconnection Agreements	41 interconnection agreements signed and approved
Expand TSR To An Additional 14 Entries; Move To Unbundled Network	15 SRTs completed; UNE-P progress constrained by Local Exchange

Entries; Move To Unbundled Network

Elements Platform	Carriers and 8 th Circuit decision
Expand AT&T Digital Link To Additional 28 Entries	28 additional entries; total now 49 outbound calling entries, 1 inbound/outbound entry (New York City)
Deploy Initial Infrastructure -- Integrated Wired Build And Fixed Wireless Beta In Chicago	Chicago build infrastructure installed according to negotiated schedule; customer traffic continues to move from leased lines to AT&T lines as deployment continues into 1998

Appendices**Back to Financial Information**

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

OPINION NO. 96-13

CASE 94-C-0095 - Proceeding on Motion of the Commission to
Examine Issues Related to the Continuing
Provision of Universal Service and to
Develop a Regulatory Framework for the
Transition to Competition in the Local
Exchange Market.

OPINION AND ORDER ADOPTING
REGULATORY FRAMEWORK

Issued and Effective: May 22, 1996

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

COMMISSIONERS:

John F. O'Mara, Chairman
Lisa Rosenblum
William D. Cotter
Eugene W. Zeltmann

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BY THE COMMISSION:

INTRODUCTION

The Commission, by this Opinion, continues to put into place the framework for a robust, dynamic competitive telecommunications market in New York. We establish parameters for a competitively neutral approach for maintaining affordable service for all New Yorkers in this new market driven environment -- a key challenge in moving to an open competitive local telecommunications market. We also consolidate here the level competitive playing field and consumer protection regime that the Commission has mapped out

in various specific cases. And we maintain our commitment to a high quality telecommunications infrastructure and encourage the development of more streamlined and flexible approaches to measuring service quality in this new market driven environment. Finally, we outline a transition monitoring plan that will enable the Commission to follow the evolution of competition and its impact on consumers.

This Commission has long promoted the emergence of competition.^{1/} The Telecommunications Act of 1996 and recent changes in technical, economic, legal, and regulatory conditions are enhancing opportunities for local exchange competition.^{2/} During the past few years, we have authorized a number of companies to provide local exchange services on a competitive basis. As more companies expressed interest in competing in this market, we determined that a more systematic examination of the fundamental issues concerning local exchange competition was necessary. By an order issued on February 10, 1994, we instituted this proceeding to develop a framework for an orderly transition to a competitive local exchange market structure and to examine issues related to continued universal provision of basic telephone services in such an environment.

^{1/} Case 29469, Regulatory Policies for Segments of the Telecommunications Industry Subject to Competition, Opinion No. 89-12 (issued May 16, 1989).

^{2/} On February 8, 1996, the Telecommunications Act of 1996 became law. The 1996 Act supports New York's policies of opening the market to competition while preserving Universal Service. The federal law reflects to a large extent New York policies and this order appears to be consistent with the relevant statutory provisions. The interrelationship between the 1996 Act and New York policies is being explored further in other proceedings.

We are embarking on the transition to that market environment. In most areas of the state, local exchange competition is negligible with only one local service provider. While limited competitive alternatives exist in a few locales, how fast it will spread remains uncertain. The regulatory framework described herein is intended to facilitate competitive choice and protect captive consumers during the transition to fully competitive markets. Should genuine customer choice emerge, the framework contemplates our re-examining the continuing need for regulatory protections and the elimination of those that become unnecessary.

Ultimately, we envision fully competitive local exchange markets throughout New York State. Multiple carriers will provide a full and expanding range of services to meet the needs and desires of all types of telecommunications users. Consumers will shop among local service providers to find the package of capabilities, price, and quality that best meets their individual needs. They will be able to switch easily to a different service provider if dissatisfied with their current provider or tempted by a better deal. Should such an environment develop most, if not all, regulation of the local exchange market would be eliminated.

OVERARCHING PRINCIPLES

Of necessity, developing a viable regulatory framework for a transitional environment requires a balancing of the sometimes competing interests of the affected constituencies -- consumers, incumbent local exchange companies, and new entrants. In striking these balances, we are guided by several overarching principles:

1. The goal of ensuring the provision

of quality telecommunications services
at reasonable rates is primary.

The primacy of this particular goal is of fundamental importance. While other goals in this proceeding may be important, even critical, to various parties, their attainment must not come at the expense of this primary goal.

2. Where feasible, competition is the most efficient way by which the primary goal may be achieved.

We have a long and successful history of enabling the development of competitive markets and seek here to establish a framework for further competitive development.

3. Regulation should reflect market conditions.

Our regulatory framework must be designed for the present transitional market, not for yesterday's monopoly nor for the fully competitive market that may ultimately develop. As such, rules should not be imposed which perpetuate or assume monopoly conditions; neither should regulatory protections be abandoned merely on the promise that the market may eventually provide them.

4. Providers in like circumstances should be subject to like regulation.

Similar regulation should be expected for providers with similar market power. Differential regulation may be appropriate and necessary where significant market power differentials exist.

The comprehensive regulatory structure adopted here provides extensive opportunities for local exchange

competition to develop in all areas in the state. This transitional framework builds on our prior actions (e.g., interconnection, unbundling, and incentive regulatory plans) and recognizes an ongoing need to reevaluate and reduce regulation as competition develops. The framework, broadly viewed, comprises three elements: provisions for competitive entry, opportunities for competitive response, and consumer protections.

Local exchange service is fundamentally about providing a communications path from the customer's location^{1/} to a point connecting to networks serving the rest of the world. Effective local exchange competition can develop only if new providers have the ability to provide these paths.

On one hand, this requires that all local carriers can interconnect with other carriers' networks and cooperatively deliver calls from one customer to any other. Thus, building on previously adopted policies, the framework requires all local carriers to provide each other comparably efficient interconnections for the exchange of traffic. And our prior determinations on intercarrier compensation place competing local carriers on economically comparable footing with respect to terminating each others' traffic.

On the other hand, recognizing that few, if any, potential competitors will be able to deploy ubiquitous local facilities of their own quickly, requirements for unbundling and resale will enable any carrier to serve any customer through its own facilities, through resale (rebranding) of

^{1/} Historically, this location was fixed (e.g., a home or business). With the development of various wireless technologies, this "static" concept may give way to one that recognizes the growing use of mobile telecommunications services.

another carrier's local services, or through purchase of network functions and elements. These provisions make it possible for all local carriers to serve any willing customer in their chosen service territories, bringing all customers the benefits of competitive choice and reducing the need to impose a "universal service" obligation on any one carrier in a given territory.

To the greatest extent possible, the framework is designed to leave the market free to define itself. Carriers, new entrants and incumbents alike, are given wide latitude to choose where they wish to offer service, subject to a common carrier obligation within any service territory they elect to define and universal service obligations. They will also be free to offer any service package they deem appropriate, subject only to requirements that residence packages include, at a minimum, some very basic elements (the basic service list) and that they provide an acceptable quality of service overall. Consistent with past policy, non-dominant providers are generally afforded pricing flexibility, and pricing constraints on dominant providers are relaxed where they face competition.

Seeking to ensure the broadest benefit for all customer classes, the framework is designed to encourage and ensure the continued provision of affordable service to all customers. Our prior determination in this case to provide all "full-service, facilities-based" local carriers comparable access charge arrangements, coupled with proposals here to initiate processes to establish appropriate universal service funding should preserve all consumers' current access to affordable service, while encouraging new entrants to offer competitive alternatives. In addition, we are adopting exit

requirements, discussed below, which preclude any carrier from simply abandoning service to its existing customers in order to provide us the opportunity to take action to ensure the availability of basic service in all areas of the state.

While providing significant opportunities to new entrants in the local service market, the framework also enables incumbent providers to ensure their own success by responding efficiently and competitively. The two largest incumbents, New York Telephone Company and Rochester Telephone Corp., have already entered regulatory arrangements that provide them opportunities to recover their investments, and even enhance their earnings, by improving efficiency, offering new services, and pricing competitively. The remaining incumbents are encouraged to enter similar regulatory agreements.

Ultimately, all aspects of this framework are intended to protect and benefit consumers. As competition for most local services and in most areas has yet to develop, market forces may not immediately protect most individual consumer's and the public's interests. Thus, during the transition to full competition, we will enforce and monitor some basic service quality standards for all local carriers and retain necessary regulatory protections aimed primarily at residential consumers and the general public interest.

PROCESS

Our instituting order designated four major areas of inquiry in this proceeding. Issues affecting the interests of consumers and competing carriers were divided into these four separate modules:

MOD 1 - Universal Service:

Issues surrounding universally affordable basic services and funding therefor.

MOD 2 - Level Play:

Publication of directories, provision of directory assistance, network interconnection requirements, number portability, and intercarrier compensation.

MOD 3 - Transition Regulation:

Reporting requirements, treatment of stranded investment, pricing policies, and other regulatory requirements.

MOD 4 - Service Quality and Monitoring:

The degree to which existing service quality standards should apply to local service providers in a competitive environment, monitoring the development and effectiveness of competitive local markets and of the state's network infrastructure.

These four modules comprehensively addressed issues necessary to establish a fair and open competitive market. In addition to written comments, several collaborative meetings were held, primarily in the universal service and level play modules, to develop the issues and appropriate solutions, and to explore areas where interdependence existed.

Public involvement initiatives were also held across the state during October and November 1994. Several different formats were used to inform customers of and elicit their views on all of the issues raised in this proceeding, including consumer roundtable discussions, cable TV call-in

programs, and video conferences. Overall, nearly one hundred consumers participated directly in these events and an estimated 1,000 consumers viewed the cable TV call-in program.

Over the course of the proceeding, staff produced draft reports in each module detailing the issues raised, analyzing the parties' positions thereon, considering options, and recommending appropriate resolutions. In August 1995, final drafts of each module's report were provided to the parties, who were then given an opportunity to comment on the coordination and consistency of all of staff's recommendations. Based on those comments and further examination of the many interrelated issues in the four modules, staff modified a number of its prior recommendations to produce the integrated framework adopted here.

Several issues have arisen during the course of this proceeding that require further refinement and input from interested parties. These issues, which are discussed later in this Opinion and Order, are listed here for ease of reference. We will issue separate orders to initiate further processes in this proceeding for each of the following issue areas in order to:

1. Develop appropriate Universal Service funding mechanisms consistent with the parameters in this Opinion and further examination of appropriate interexchange access charge levels that will be conducted in Case 28425;
2. Explore the benefits and potential terms, conditions, and pricing of the sale by all local exchange carriers of directory listings, directory assistance services, and associated database access to third parties;

3. Comprehensively review, and as appropriate, revise our service quality standards and implement the streamlined three-level reporting plan described in this Opinion; and
4. Revise our rules to implement the market monitoring plan described in this Opinion.

UNIVERSAL SERVICE

The goal of ensuring that all residents of the State have access to affordable basic telephone service is referred to as universal service. Universal service enhances the ability of all persons to communicate with one another; to access public safety, health, education, and assistance services; and to participate more fully in society. As telecommunications services evolve and the industry becomes more competitive, the effectiveness of current public policies designed to foster universal service bears reexamination.

The following principles form the foundation for our universal service policy for residential consumers:

1. Basic services should be evaluated and revised as necessary to meet evolving needs.
2. Basic services should be available to all residential customers who wish to use them.
3. Basic services should be accessible.
4. Basic services should be affordable and reasonably priced.
5. Funding mechanisms to support universal service must be fair, equitable and competitively neutral.

Basic Service

As the competitive transition evolves, we will continue to ensure the provision of basic telephone service, at an affordable rate, to New York's customers. Basic service is a dynamic term that refers to those telephone services deemed essential to minimally acceptable access to, and use of, the public telecommunications network. Those services deemed to be basic should be made universally available. As technology and markets change, the list of basic services may require revision to meet evolving customer needs.

Determinations regarding which services should be included in a basic service list should be based on established criteria. Consistent with this principle, we intend that the basic service list be re-examined every three years pending the development of a fully competitive market. Factors to be used to guide decisions concerning changes to the basic service list include the level of customer demand for the service, the public benefit it provides, the extent to which it is required to access other essential services, and the cost of providing it.

Based on these criteria, we find that the list of basic services currently should include:^{1/}

- Single Party Access Line
- Access to Local/Toll Calling
- Local Usage

^{1/} This list includes all of the basic service elements recently proposed by the FCC. Notice of Proposed Rulemaking and Order Establishing Joint Board CC Docket No. 96-45 (Released March 8, 1996), pp. 13-15.

- Tone Dialing
- Access To Emergency Services
- Access To Assistance Services
- Access to Telecommunications Relay Services
- Directory Listing
- Privacy Protections

Availability

Basic services should be available to all residents who wish to use them. Residential services should include, at a minimum, the basic service elements listed above and, consistent with existing rules, these services must be available to all residential customers in the provider's service territory. There are virtually no areas in New York where the telephone service is not now available. And all carriers will be subject to common carriage obligations. Thus, we believe it is unnecessary to designate a "carrier of last resort" to guarantee continued service availability. Carriers desiring to withdraw basic service offerings in any service territory will be subject to exit requirements (essentially notice requirements) to ensure that basic service is not interrupted. These exit requirements will be formalized in the next phase of this proceeding.

Accessibility

The value to New Yorkers of our telephone network is enhanced by virtue of the ability to reach other New Yorkers. Although the public network is physically available to all New Yorkers, barriers to universal service remain for certain

segments of society. These barriers include socioeconomic conditions as well as the inability to obtain special telephone equipment. Potential users may require some assistance, if income eligible, as well as appropriate information about the availability of telephone services, assistance programs, or special equipment and services to enhance their opportunity to utilize the public telephone network. We support the automatic enrollment/removal programs for Lifeline service being implemented by New York Telephone Company and Rochester Telephone, and we will direct staff to pursue their expansion to other companies. This program provides assistance to eligible consumers in an efficient manner and ensures that only those who are eligible continue to receive assistance. Our goals for expansion of automatic enrollment/removal programs are competitive neutrality (i.e., the program be available to all providers) and efficiency, while maintaining privacy protection. Staff has identified legitimate concerns about low phone penetration among certain consumer categories. Staff should continue to study the reasons for this low telephone penetration to determine whether actions can be taken to facilitate access to the network.

Funding Universal Service

To begin, because there is broad agreement for funding programs such as Lifeline, emergency services (e.g., "911"), and the Telecommunications Relay Service on an explicit, competitively neutral basis, the details for implementing such a funding mechanism should now be developed. The three programs cited above may be augmented in the future. For example, the Telecommunications Act of 1996 (the Act)

requires us to establish discount rates for schools, libraries, and perhaps certain health care providers. Based on the parties' collaborative efforts, staff has recommended a "Targeted Accessibility Fund" to which all regulated telecommunications carriers would contribute and from which funding would be disbursed to carriers based on their levels of subscription to the targeted services. Administration of the proposed fund would be handled by an independent entity, subject to our oversight. As previously indicated, we will ask interested parties to develop and recommend mechanics for such funding through a further collaborative phase in this proceeding.

Affordable Rates

Our long standing policy is to ensure basic services are affordably priced to all residents who wish to subscribe.^{1/} There may be upward pressure on basic service rates in the future as competition and other regulatory actions impact traditional rate designs.

For the two largest incumbents (New York Telephone and Rochester Telephone), the Commission has adopted long-term incentive plans that ensure basic rate affordability, at least for the next five to seven years. Both of these plans preserve affordability by capping basic service rates, while providing reasonable opportunities for cost recovery through pricing flexibility for new and competitive services. The companies gain opportunities for greater earnings if they can improve efficiency and compete successfully in new markets,

^{1/} Although all of the elements of "basic service" (as defined above) should be "affordable," the monthly subscription rate traditionally has been the focus of the "affordability" issue and is the "basic service rate" referred to in this section.

but also bear the risk of poor earnings and "stranded revenue requirement" if they do not.

Together, these two companies serve 95% of the local telephone customers in the state. While efforts are being made to encourage other incumbent local exchange companies to enter similar incentive plans,^{1/} those that do not must still be transitioned to a competitive environment.

There are several cost recovery issues, which are often confusingly intermingled. First, there is the question of recovery of the relevant cost of basic service. Second, there is the issue of competitive losses or stranded revenue requirement. Finally, there is the problem of overall revenue requirement recovery. The critical universal service questions are "to what extent must basic service be priced below its cost to maintain universal service" and "what is the relevant measure of cost?"

In defining the relevant measure of cost, we must recognize that for any business to remain financially sound, revenues must recover costs. In particular, for a regulated telephone company, pricing all services at incremental cost would, most likely, leave the company with an overall revenue deficiency.

As we move toward a more competitive environment, local telephone companies must be ready to compete effectively with entrants to their markets who are able to successfully price at or below the incumbents' costs. Thus, the incumbents must institute, now, revenue enhancing and cost-cutting measures. Incumbent carriers should also have the flexibility to meet their competition. We have substantially relaxed

^{1/} An incentive plan for Taconic Telephone Corporation is currently being negotiated.

constraints on earnings and granted greater price flexibility to incumbents for those services that face competition. We intend to continue this policy during the transition to local exchange competition.

As an integral element of the broader regulatory scheme that includes increased pricing and earnings flexibility as local competition grows, we are examining the establishment of a funding mechanism to ensure affordable basic rates for high cost areas for companies that are not under long-term incentive plans. This mechanism should consider funding, on a competitively neutral basis, the long run incremental cost of providing basic service to the extent it exceeds an affordable rate. We are also considering whether some limited, transitional funding is needed for the recovery of a portion of incumbents' embedded costs associated with the provision of basic service in high cost areas. Such funding would provide a limited cushion against significant competitive revenue losses in the early years that are associated with universal service, while requiring the incumbent to adjust to the rigors of a competitive market as time passes. Such a funding mechanism would not guarantee any company perpetual recovery of its total costs, but instead would ensure that remaining captive customers continue to have affordable services available to them.

Rate design changes, including the possibility of further carrier access charge reductions, may create a universal service funding issue. In 1985, we began a process of reducing carrier access charges and allowing basic rates to increase if necessary to make up the revenue loss.^{1/} In this

^{1/} In 1985, the Commission articulated a policy of phasing out
(continued...)

proceeding, the interexchange carriers have pressed for lower access charges and appear to contend that basic service revenues are not significantly less than long-run incremental costs and, therefore, require only a modest contribution from other services. The merits of further access charge reductions will be considered as part of and in connection with the development of a rate affordability fund for basic rates in high cost areas.

All of these funding issues need further development and input from the parties and will be examined in the next phase of this proceeding.^{1/} The parties should develop the mechanics of a Targeted Accessibility Fund to finance socially beneficial programs, including Lifeline, emergency services (e.g., "911"), and the Telecommunications Relay Service, as discussed above. Consideration must also be given to appropriate funding vehicles for federally mandated discounts for schools, libraries and perhaps certain health care providers. The scope and mechanics of a fund to ensure generally affordable basic rates warrant further consideration by the parties consistent with the parameters discussed above. We will initiate a further phase of this proceeding to allow parties to address these issues and to recommend specific mechanics for any funds proposed. Any funding mechanisms proposed must be competitively neutral, easily administered

(...continued)

the non-traffic sensitive costs included in carrier access charges. Case 28710, Bypass of Local Exchange or Toll Networks, Opinion No. 85-15 (issued October 3, 1985).

^{1/} We are mindful that our efforts to preserve and advance universal service must not burden Federal universal service support mechanisms.

and auditable, so as to be accountable to the Commission and the public.

LEVEL PLAY

We have concluded that competition is in the public interest.^{1/} Technology is available (including cable television and wireless facilities) that may allow competition for local telephone services, but the existing market is highly concentrated and largely a monopoly.

Our objective is to remove barriers to competitive entry into the local markets and to establish a "level playing field" for competing providers of local exchange service. To achieve that objective we developed a set of foundation principles:^{2/}

1. Customers must be able to call all valid telephone numbers.
2. Telephone numbers are a common resource to be shared among carriers.

^{1/} Case 29469, Opinion 89-12, Opinion and Order Concerning Regulatory Response to Competition (issued May 16, 1989). This finding is entirely consistent with the Telecommunications Act of 1996.

^{2/} By Orders in this proceeding dated March 8, 1995 (Order Requiring Interim Number Portability Directing a Study of the Feasibility of a Trial of True Number Portability and Directing Further Collaboration) and September 27, 1995 (Order Instituting Framework for Directory Listings, Carrier Interconnection, and Inter-carrier Compensation), we have endorsed the main body of these principles and most of the matters detailed here. While no further action is required on such matters, the findings related to these issues are repeated here to provide additional context and a complete summary of the decisions to date.